

EPISODE 566

[ASK FARNOOSH]

[0:00:32.2]

FT: How much did you allocate for rent? Are defined benefit plans better than defined contribution plans? Welcome to So Money everyone. It's Ask Farnoosh time. We got a lot of interesting questions to tackle. I'm your host, Farnoosh Torabi. It is April 28th.

I had a really fun time interviewing Chris Winfield this week. If you missed that episode, that was Wednesday episode, episode 565. Chris is a time management expert and he gave me some really crucial advice on how to deal with a current situation in my life, which is finishing up a commencement speech. I'm headed to Penn State in a couple of weeks. I'm really excited.

As you know, I graduated from Penn State and I have this tremendous honor of giving the commencement speech for the Smeal College, the Smeal business students. Having the baby and with work and everything, I, of course, was procrastinating on the speech. He gave me some really great advice on how to tackle that and I'm happy to say that I have the draft done and now I'm just in practice mode. Thank you to Chris Winfield. I really encourage you to go back and listen to that episode if you're just curious about how to become a morning person, how to get all your work done in half the time essentially is what he promises.

Sophia, welcome to the show. What did you think of Chris' interview?

[0:01:50.0]

SY: I thought it was really great. I was really inspired by what he had to say. Who doesn't want to do all of your work in half the time?

[0:01:58.1]

FT: It's almost unbelievable, and I just said that at the beginning. I said, "There's no way it's a false promise, Chris. Get — I don't know — 40 hours of work done in 16 hours?" He really breaks it down on the podcast and I told him, I joked in the beginning and I said, "If Tim Ferriss and Hal Elrod, who's another guest on the show, who's a time management expert, had a love child, it would be Chris Winfield." He was really fun to interview. I encourage you to go back and listen.

Sophia, I need to mention that I have been fact checked by listeners, and sometimes I get some things wrong on the show. Not always. Not often, but occasionally. I'm lucky enough that my listeners call me out on it. I want to correct that right here and now and say that last Friday, episode 563 I believe it was; Ask Farnoosh, Kate wrote a very good question and she asked about IRAs and whether she can invest in multiple IRAs at the same time. She has a traditional IRA already and now she's at a new job that has a simple IRA. She's also thinking of opening a Roth IRA. That's three different IRAs; one through work, one that she already has, the traditional, and then also a Roth IRA down the road. Can she invest in all of these things?

I was half right in my answer. I stated that she could invest in all three, which is true, but there are some limitations that you need to be aware of. This is where I got it wrong. With her work IRA, this simple IRA that she's getting through work, she can invest the limit that the employer allows in that account. She didn't say how much, but just go with the rules that your employer sets for that simple IRA.

Outside of work, if you're going to open up multiple IRAs, the IRS limits you to invest in no more than \$5,500 a year total spread across his IRAs. If you just one IRA, you could put the whole \$5,500 in that one IRA. If you have three, then you have to make sure that the sum, those contributions in that year, that tax year, is no more than \$5,000. That number sometimes changes. This year it's 5,500. Next year, who knows? It's important to keep up with IRS rules.

What I had said incorrectly in that episode is that including her work IRA and the Roth and the traditional IRA, her maximum total contribution cannot exceed 5,500, but my correction now is that she can invest up to the limit that her employer allows in that simple IRA through work, and then outside of work, the contributions cannot exceed 5,500. All right.

Thank you to Ann Pugh who corrected me on that. She's a loyal listener. She works at a financial advisory in Missouri. Thank you, Ann. Just some people in social people had done a double take, and so I thank you for that, and I pride myself on the fact that I don't often get corrected on this show. We do our due diligence here and we have a lot of great resources that we tap to make sure that the information that we provide is accurate, but when we make a mistake, we're also trying to be quick to correct it.

If you go back to the episode 563, we have entirely taken out that question. That was just easier for us to do, but I'm letting you know in the following episode what we did, and the correction. If you ever want to get in touch with me, go to somoneypodcat.com and click on Ask Farnoosh. Thanks to everybody who wrote in for today's episode.

Like I mentioned at the top, we've got questions about rent. How much should you spend on rent given your salary? Of course, retirement. A lot of questions today on retirement. Let's start today with Melissa, Sophia, who's got a question about whether to contribute to one plan or another. She's a little confused.

[0:06:00.9]

SY: Yes. Right now, she's starting a new job in August where she won't be contributing to social security, but she will have the choice to participate in either a defined benefit or defined contribution plan.

She's required to contribute 8% and her employer will match that dollar for dollar. She has the option of choosing the defined benefit plan which would pay up to 80% of her final salary upon retirement or the self-managed option in which she invests her money. What do you think?

[0:06:30.0]

FT: All right. I'm not sure why she can't contribute to social security with this job, but I guess that's a sidebar. I think that she really needs to think about her long term plans. Listen, a defined benefit plan is basically a pension, and we know pensions are making their way out of workplaces. Companies are not offering pensions as much as they were in the past. A pension

is a guarantee. You pay into it while you work there, and then when you retire, even though maybe you're not working there anymore, you should receive a check at some point with a defined benefit, a weekly or monthly check. Sometimes people take a lump sum.

That can be pretty attractive given that we don't know what's going to happen with the market. I think a defined benefit might be great for somebody who is approaching retirement and maybe also has some investments, but really wants to bank on some certainty. Wants to know, "What will I necessarily have?" and the rest can be more ballpark estimates. With a defined benefit, you know exactly what you're getting, and that can be helpful when you're planning your retirement and if it's coming up soon.

Melissa is how old? Do we know?

[0:07:44.1]

SY: She's 33 and she plans on staying at this job for five years so she can be fully vested.

[0:07:49.2]

FT: Okay. All right, great. There are benefits to defined benefits plans, the main benefit being that it's a guarantee and nothing is really guaranteed anymore. She's 33, she has a long investment horizon until she retires. She can ride out this market.

I like 401(k)s and other kinds of workplace retirement plans, because they allow you to have a little bit more control over how much you contribute. I think over 30 years, with a defined contribution plan of consistent investing, she'll have more money at the end of the day, and she can take this 401(k) or whatever it's called at her workplace and move it over to an IRA if she leaves that job or roll it over into her new workplace 401(k) as she changes jobs. It's the kind of thing that can move along with her, whereas the defined benefit plan or pension sort of stays with the employer. If you leave, you can't contribute to it anymore. Yes, it will be a guarantee when you retire, but it's probably not going to be as big of a payout given also that she's just 33.

Those are the things that she has to think about. If I were her, I'd probably do the defined contribution plan, the 401(k), again, because I have this long investment horizon. I can ride the market. Most likely end up with more money that I started and a lot more money than if you were just contributing for five years in a defined benefit plan.

Good luck, Melissa, and congrats that you have these options. I think most people don't have the option of a defined benefit plan, and I think a lot of us are finding out that even we have a 401(k), there might be restrictions limitations. Of course, some companies are doing away with those plans altogether.

All right Melissa, good luck, and thanks for your questions.

[0:09:36.2]

SY: All right. We have another question about 401(k)s, this time it's from Krysten. For 10 years she's been matching her company's 401(k) and two years ago they started offering a Roth IRA, but they will only match one. Since she's put 10 years into the 401(k), should she keep putting money towards this and money to the Roth?

[0:09:56.6]

FT: We talk on this show quite often about diversifying your tax exposure in retirement, and this could be an opportunity for her to do that. She's had the 401(k). As we know, the 401(k) contributions reduces your taxes today. Then, in retirement, when you make those withdrawals, you get taxed on those withdrawals at your tax rate in retirement.

With a Roth IRA, you don't get the tax benefit today. You don't get to deduct those contributions from your taxable income today, but when you make those withdrawals in retirement, the withdrawals are not taxed. That's nice, to have a little bit of both going on in retirement. We don't really know what retirement will look like in terms of our tax situation. Most people can probably guess that their taxes will maybe go up as their salaries increase. I think maybe if that's something that interests her, then perhaps she could diversify and open up that Roth IRA.

Remember, a Roth IRA is only available to us up to a certain income level. If this is something that she can qualify for right now, take advantage of it perhaps. That could be a good idea. I think that going back to her 401(k) at work, because there's a match there. There's a little caveat to this, and that is that the Roth IRA, the contribution limit is \$5,500 this year. With the 401(k), the contribution limit is I believe \$18,000 this year.

Krysten, I will say this, maybe do a little bit of math before making your decision. At the end of the day, you want to take advantage of this match. If you can get more money out of your employer by investing in your 401(k) versus the Roth, then I think that you want to do as much as you can with this 401(k) to get that match, and then also maybe contribute to a Roth IRA if there's money left over.

The way you decide this is you have to factor in the fact that a Roth IRA caps you at a \$6,500 a year contribution. Whereas a 401(k), the max is \$18,000. If you get a match from your employer and you're able to get more money as a result from your employer because you have a higher limit with the 401(k), I would say do that to maximize the match. Then, if you got money left over, put it in the Roth IRA.

Does that make sense, Sophia?

[0:12:12.5]

SY: That does make sense.

[0:12:13.8]

FT: Okay. I'm just kind of — I'm going on less sleep these days given my family's situation. If you missed that, let me know. If none of that made sense, let me know. It made sense in my head, but sometimes I take for granted —

[0:12:27.0]

SY: No. It does.

[0:12:28.3]

FT: All right. I hope that made sense, Krysten. If it didn't, you know where to find me.

Okay. I see here we have a question from Olivia, and this is the question I really wanted to get to, which is about rent and how much should you really be allocating. What's her dilemma?

[0:12:40.4]

SY: Yeah. I have a lot of thoughts since I read this one. Olivia wants to know how much she should pay for rent. Right now she's making 60,000 and wants to get an apartment that's \$2,259 a month. She knows it's a lot of money, but she really, really likes it. She wants to know what is the ideal salary for her if she can afford a \$2,000 apartment in monthly rent. Right now, she's currently paying \$1,500 per month.

[0:13:07.5]

FT: Here's the math, everybody. Sophia, it sounds you're interested. Your ears are perking. I would say that the limit for budgeting for rent after taxes is about 30% of your take home pay. She's making 60K, but I suspect that that's not her net income. It's probably her gross. Let's take that down a little bit to more like 45K after taxes.

\$45,000 a year divide it by 12 months, that's her — Let's say, her budget is \$3,750 for everything. Now, you take 30% of that and you're left with about \$1,100, \$1,200, which is closer to what she's paying currently; \$1,500 per month. It's not like she's going crazy right now with her rent, and I say that's really where she needs to stay, no more than \$1,500 per month, Olivia. I know that might sound really sad to you and you've obviously found a place that you've loved and it's more money, it's like 50% more money.

I think it's important to not overspend on rent. It's your biggest expense, most likely, but if it's really more than you can afford, you're going to feel the pain in other areas in your budget. I don't know if she's got any debt, or if she hasn't really filled up her savings account, or there are

other things that she'd like to afford. Being conservative with rent just opens up so many doors so that you can afford all the other stuff that you want/need to afford.

The ideal salary for her if she can afford \$2,000 in a monthly rent, so that's a little bit of reverse math; \$2,000 times 12 months is \$24,000. If we're talking about your rent being no more than 30% of your take home pay after taxes, then we're talking about making at least a take home pay of \$72,000. Realistically, that's a salary, gross salary of 90 or more. Get the raise, Olivia, and you can afford \$2,000 in monthly rent.

Here's another bit of advice; stop looking at the apartments that are out of your price range, because that will entice you to spend more. It's like people do this all the time. Whether they're looking for a rental, or a house to buy — Gosh! Real estate, it's like, "I can't get right. I love looking at slides. I love looking at 3D virtual listings online," but you have to just curb that for yourself, because if you start looking at these other places that are out of your price range, you're going to start justifying paying more.

If you want to spend \$2,259 a month, let's just do a little quick math here. That's \$27,000 in rent a year. Out of the \$45,000 — That's more than 50% of her take home pay. That's a little crazy when you really look at the math like that. Now, if \$60,000 is her net, then in that case, I think she could be spending closer to \$1,500, maybe \$1,700 a month on rent, but I don't think she should really go above and beyond that.

In big cities like New York, the Bay Area, expensive cities, yeah, we see people here spending upwards of 40% on their rent, but maybe they're also living with a couple of roommates. Again, I think that if you can reduce your housing costs and live below your means when it comes to housing and rent, and even people who buy and they're looking at the mortgage, it's the same deal. If you can reduce that, I think that you will have a more comfortable life and you will be able to more comfortably afford so many other things.

That's my take. I'm sorry I didn't have better news her, but it is what it is. The math doesn't lie, and I would hate to say, "Yeah! Go ahead. Go! Go for the splurge, because then you'll be writing again in a few months wondering how to make ends meet in other areas. Was that too harsh?"

[0:17:26.7]

SY: No. I think it was accurate. I have a bunch of friends obviously living in New York. Obviously, to get into some of the nicer buildings, you do have to spend a little bit more. As you mentioned, it comes at a cost of being able to afford other things. I don't know if Olivia likes to go out and eat, or if she likes to workout and maybe do some workout classes as supposed to having a gym membership. A lot of those things would have to go by the wayside especially if she wants to be saving for retirement and contributing to her emergency fund. She really has to keep that into consideration too.

I agree with you. I think it's a great thought and it's something for her to work towards a goal whether it's to try to get a raise at work or to get a new job that will afford her a little bit more cash. I think she has a couple of — A little while to go until she'll be able to afford that apartment.

[0:18:20.6]

FT: Olivia, I feel you. I am known to be on real estate websites all the time. I'm always looking for the next purchase, even though I've just moved into my place and renovated it two years ago, my husband is beside himself. He's like, "Why are you going on these sites?" For me, it's entertainment, but also I'm really curious to know where the prices are going and what we could get if maybe spent a little bit more.

It's one of those things where you can really just get super jaded and think, "Well, okay. I really need that washer and dryer in my apartment, so I'm willing to spend the extra \$300 a month for it." If you set your laundry out every day, it wouldn't cost you \$300 a month. It's just one of those things where you start to justify the expense when the money could be better spent in other area and invested in other areas.

All right, let's see here. Christine has got a question about securing your employment. I like this question. Take it away, Sophia.

[0:19:25.8]

SY: Yeah. She wants to know based on your experience with interviewing your guests; what hard skills would you recommend young professionals learn in order to protect themselves against future financial layoffs or jobs that are going to be taken over by automated technology in the future?

[0:19:44.2]

FT: I would say that even though robots could do it, I do think that programming skills and software skills are at the very least, today, essential to finding a job. Not that everybody has to have these skills, but if you are interested in being employed in tech and you want to compete well with other people who are applying for the same job that may not have software skills or may not know how to just do basic coding, I think that could be a really advantage.

My husband is a software developer and he says it all the time, especially for women. He says that there's a huge under-population of women in tech. At his company, he's really supportive of his female colleagues. I think he's always talking to women about pursuing this if they're interested, because he really sees a demand for more diversity and technology. Yeah, it's tech, so robots I guess could do it.

I think the way that we are using the internet these days does require humans to be programming, because how we use the internet is very behavioral. It's very psychological. I'm giving you an example of my brother who graduated from college, in business, had a degree in economics and entrepreneurship, but when he went to job fairs, Sophia, he heard over and over again that while your resume is great, you seem like a nice kid, you don't have hard skills. He's like, "But I can show you a yield curve." They're like, "No. That's not really an asset to us, or that's not really a value. It doesn't really drive the needle."

He went back to school, not like a graduate school, or a master's program where he's locked up for two years in academia. He took an intensive — I believe it was a nine-week course at General Assembly, which is an online school that teaches a lot of these technical skills and hard skills that Christine is talking about, and he basically learned UX design, which is — I think I would say it's design meets psychology; learning how to build and layout an architect apps and

websites for different brands and companies and services to make it friendly to the user, to the end user, to you and I.

You know what? Pretty soon after he finished that program, he started working, and he's been working since, and he works for a great firm now, and he's doing exactly what he studied and he just negotiated a really nice salary for himself. Learning skills that have anything to do with the internet, whether it's the backend or front-end, I think can be really, really valuable and a real asset.

The other thing Christine is — That while we're talking a lot about tech and hard skills, don't discount soft skills either, like being able to communicate, and lead, and manage, and write well. Listen, they're not teaching grammar anymore in elementary schools. Can you believe it? They're not teaching handwriting. They're not teaching sentence structure.

At private schools in Brooklyn, I just learned today, they're getting rid of a lot of the stuff that we grew up with as a basic part of our education. If you can bring that to the table, that might be something that you may be the only one in the team that can do that eventually, and that will still be — I think, still be an asset to be able to story tell, and write well, and communicate.

It's really sad that schools are getting rid of it, but the way I guess they see it is like we're such a tech-driven world. Everything is on the computer. Everything is automated. We want to focus on competing with big nations like China and Russia. We need to create these students who can do math in their sleep. It's like, "Okay."

Let's be honest. I think the art of writing should not be a lost art. Come on. I went to journalism school, so obviously writing is important for me in my field. Even as journalists, it's important to be able to have a tech savviness and a tech awareness. At the end of the day, professors always told us, "If you know how to write well, you will always be employed." Don't forget that. Don't think that just because we're now moving towards blogging, in these short articles, in these snippets, and nobody writes long form anymore.

If you have that talent, you can build off that and you'll become known as having that talent, which in the end of the day, I think companies still respect and still want to have people who can write well and communicate well in their teams. It's what keeps the livelihood alive.

Companies are so curious about how to retain employees, so obsessed with culture, and finding the right people and the right balance. I think if you're well-rounded and you can do all sorts of things — I'm not saying you're never going to get unemployed, or laid off. That happens to the best of us, and I'm raising my hand. I've been laid off. I've been almost fired. I hear her. She wants to just prepare as much as she can. These are the kinds of skills that if you were to turn entrepreneurial, would serve you as well.

Christine, thanks for your question. I hope that wasn't too longwinded of an answer. Bottom line, hard skills; like software, tech-oriented skills, I think can't hurt, especially for women, because there's a lack of women in representation in that industry, but also soft skills, like being good leaders and being good communicators and good writers can go a very long way as well.

All right, last but not least; Angel. What's on his money mind?

[0:25:17.8]

SY: Angel is in his mid-20s, and he recently decided to get serious about his money. He has a 401(k) with his company which he has maxed out, but no savings account of any kind. He only has a thousand dollars in his emergency fund. He wants to know where is the best place for him to put this \$1,000 to earn the most back.

[0:25:37.7]

FT: Very timely question, Angel. I've actually just finished writing a piece for the Mind blog, mint.com. I'm not sure if it's up yet, but it was essentially answering your question; where to put your cash. Depending on your goal with this money, the cash would probably go in one a few places. I think, for you, because you're still building this emergency account and the purpose is for it to serve you in an emergency, in a pinch, in a hurry in case your breaks down, or you got a

dental bill and your insurance only covers half of it and you weren't expecting to get those bill. Oh my gosh! What are you going to do?

You want to have access to this money. You want to keep it somewhere obviously safe. I would not be so concerned with the interest, because even if you were at a bank that was earning, these days, the best yield. It's like maybe a percent, or 1-1/4 percent. On a thousand dollars, that's now much to ride home about.

First and foremost, I think you want to identify a bank that is convenient, meaning that it's accessible to you. Maybe there's some ATM in your neighborhood that won't be charging you a fee for withdrawing from that account, where it's FDIC insured. For some people, it's important to pick a bank where they're also doing other kinds of banking. If you've got a credit card with a particular bank, you've got another kind of account, investment account at the same bank, maybe also under that same umbrella, you want to open up a savings account, because some people just like to have everything streamlined.

If you're also concerned about interest, then shop around, browse the web, sites like nerdwallet.com, and bankrate.com, can rank online and brick and mortar banks based on the APY. Traditionally, online banks are where you're going to see the highest interest rates, because they don't have the overhead like brick and mortar banks do. There, you might be losing out on some accessibility. There might not be ATMs tied to that online bank near you, and so you're going to be paying fees every time you withdraw.

Lots to consider, but I don't think that you should leave your search based on interest, because it's not that much money. More importantly, you just want to park this cash somewhere that's going to be accessible to you and safely kept. Yeah, check out NerdWallet and bankrate.com, and keep contributing to that savings. It's great to know that you're investing in your retirement, being that you're in your 20's, that will be awesome when you're my age. You're going to be so happy that you started young.

Also, I want you to really bulk up that savings account, because you just never know what might come around the corner unexpectedly, even in your 20s. You're not invincible. On that note,

thank you so much for these awesome questions guys. It's no nice to be back working. I have to say, I have new found respect for stay at home parents. I really do.

I don't know how they do it. I don't know how they stay sane. I'm home sometimes with my two kids under the age of three alone and I'm ecobunkers. It's like many hours go by, not because it's boring, it's because there's a lot of work. It's like — As soon as one baby is done crying, the other one wants milk, and the other one wants to play. It's nonstop. I think my job is a lot easier than parenting full-time. Really, it is, because I have you. I have you, Sophia. Thank you, Sophia, for joining me and chiming in. Always great to hear from the younger generation, because I feel like I'm just getting older.

Anyway, I hope everybody has a great weekend, and I'll see you back here in May. All right, thanks so much, and I hope your weekend is so money.

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